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In the

Supreme Court of the United States.

OCTOBER TERM, 1929.

No. 535. 22

WILLCUTTS, Collector of Internal Revenue,

v.

CHARLES W. BUNN.

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*, AND BRIEF IN SUPPORT THEREOF.

JOSEPH E. WARNER,
Attorney General of Massachusetts.
R. AMMI CUTTER,
Assistant Attorney General of Massachusetts.

Of Counsel:

HENRY F. LONG,
Commissioner of Corporations and Taxation of Massachusetts.

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SUBJECT INDEX.

	Page
Reference to report of decision below	3
Statement of the case	3
Grounds upon which leave to file brief as *amicus curiae* is sought	4
Points and authorities	5
I. Gains from the sale of stocks, bonds, and other intangible personal property are derived from the use of business acumen and knowledge of investments. Taxation of such net gains from human endeavor imposes no perceptible burden upon the intangible property sold—even though it consist of tax-exempt bonds	6
II. The implied prohibitions of the Constitution of the United States protect the obligations of one member of our system of dual sovereign governments only from taxation by the other government which burdens directly and substantially the obligations themselves or the interest upon them	9

TABLE OF CASES CITED.

Blodgett v. Silberman, 277 U.S. 1	10
Doyle v. Mitchell Bros. Co., 247 U.S. 179	6, 7
Eisner v. Macomber, 252 U.S. 189	6
Flint v. Stone Tracy Co., 220 U.S. 107	9, 10
Greiner v. Lewellyn, 258 U.S. 384	10
Hamilton Co. v. Massachusetts, 6 Wall. 632	10
Home Insurance Co. v. New York, 134 U.S. 594	10
Lucas v. Howard, U.S. Supr. Ct., Oct. Term, 1929, No. 52	10
Macallen Co. v. Massachusetts, 279 U.S. 620	9, 10
Merchants Loan & Trust Co. v. Smietanka, 255 U.S. 509	7
Metcalf & Eddy v. Mitchell, 269 U.S. 514	10, 11
Miller v. Milwaukee, 272 U.S. 713	9

Page

National Life Insurance Co. v. United States, 277 U.S. 508 9
Plummer v. Coler, 178 U.S. 115 10
Provident Institution v. Massachusetts, 6 Wall. 611 10
Society for Savings v. Coite, 6 Wall. 594 10
Stratton's Independence v. Howbert, 231 U.S. 399 6
Taft v. Bowers, 278 U.S. 470 7
Tax Commissioner v. Putnam, 227 Mass. 522 7, 8

TABLE OF AUTHORITIES CITED.

43 Harvard Law Review, 280 10
Mass. General Laws (1921), c. 62, sec. 5 (*c*) 4
Regulation 8001 of the Department of Corporations and Taxation 5
Regulation 8002 of the Department of Corporations and Taxation 5

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MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*.

And now come the undersigned, as counsel for the Commonwealth of Massachusetts, and respectfully move for leave of this Honorable Court to file the accompanying brief in the above-entitled case as *amicus curiae*, both upon the petition for *certiorari* and upon the argument of the principal case, if the petition for *certiorari* be granted.

JOSEPH E. WARNER,
Attorney General of Massachusetts.
R. AMMI CUTTER,
Assistant Attorney General of Massachusetts.

Of Counsel:

HENRY F. LONG, Commissioner of Corporations and Taxation of Massachusetts.

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CHARLES W. BUNN.

BRIEF OF THE COMMONWEALTH OF MASSACHUSETTS AS *AMICUS CURIAE*.

REFERENCE TO REPORT OF DECISION BELOW.

The case below is reported as follows: District Court of the United States for the District of Minnesota (*Cant*, J.), 29 Fed. (2d) 132, *sub nom. Bunn* v. *Willcutts, Collector*, decided November 17, 1928, Circuit Court of Appeals, Eighth Circuit (*Stone, Booth*, and *Gardner*, JJ.), 35 Fed. (2d) 29, decided September 16, 1929.

STATEMENT OF THE CASE.

This was an action (R. 1) by the taxpayer, Mr. *Bunn*, to recover a Federal income tax assessed upon *gains* received by the taxpayer from the *sale* of municipal bonds issued by counties or cities in Minnesota. The Collector

demurred to the petition (R. 3). The demurrer was overruled (29 Fed. (2d) 132, R. 4). The Collector stood upon his demurrer and appealed, and the judgment was affirmed (35 Fed. (2d) 29, R. 14, 17). The government is now petitioning for *certiorari*. The ground of the decisions below was that profits from the sale of state municipal securities are not constitutionally subject to taxation as income by the Federal Government, the courts below taking the view that such taxation would be an impairment of the power of the States and of their subdivisions to borrow money to carry out the powers reserved to them by Article X of the Amendments to the Constitution of the United States. No questions of the taxation of the *principal amount* of state bonds or of *interest* upon state bonds is here involved.

GROUNDS UPON WHICH LEAVE TO FILE BRIEF AS *AMICUS CURIAE* IS SOUGHT.

If the doctrine, announced in its particular application for the first time by the courts below, is sustained, the States will be subjected to the converse of the doctrine—and will be foreclosed from taxing as income profits received by their inhabitants from the sale of Federal securities.

Massachusetts has, since 1916, imposed a tax upon income from the gains from the sale of intangible personal property, including Federal securities.

GENERAL LAWS OF MASSACHUSETTS (1921), c. 62, § 5 (*c*), as amended by ST. 1928, c. 217, § 1:

> "Income of the following classes received by any inhabitant of the commonwealth during the preceding calendar year shall be taxed as follows:
>
> * * * * * * * *
>
> "(*c*) The excess of the gains over the losses received by the taxpayer from purchases or sales of

intangible personal property, whether or not said taxpayer is engaged in the business of dealing in such property, shall be taxed at the rate of three per cent per annum. . . ."

The regulations of the Department of Corporations and Taxation construing said section with respect to so-called "tax exempt" bonds read:

> "8001. The tax of 3 per cent upon the excess of the gains over the losses from purchases or sales of intangible personal property shall be imposed upon the excess of such gains from dealings in stocks, bonds, certificates of indebtedness, notes, bills receivable, 'futures,' 'puts,' 'calls,' 'rights,' and all other classes of intangible personal property.
>
> "8002. The tax upon the excess of gains over losses shall be imposed upon the amount of such excess, irrespective of whether the property involved in such transactions is taxable or non-taxable on its income."

The question of the power of the State to tax the gains received from the sale of Federal Government bonds has not been passed upon by any Massachusetts court. The decision in the case at bar by this Honorable Court will, as a matter of practical fact and of logic and reason, decide the question.

POINTS AND AUTHORITIES.

Massachusetts contends that the decision below was erroneous because—

1. The non-discriminatory taxation of all gains derived from the use of business knowledge and of human ingenuity in dealings in intangible property can have no

material effect to impair the ability of a government to issue its bonds and obligations, even if gains from the sale of such bonds are subjected to the tax.

2. The history of the exemption of state instrumentalities from Federal taxation and of the exemption of Federal instrumentalities from state taxation reveals that the doctrine of exemption has protected governmental obligations only from taxation of the principal amount of such obligations and of the stated interest upon such obligations. This appears not only from the statutes authorizing such tax-exempt obligations, but also from the court decisions construing express and implied constitutional provisions.

I.

GAINS FROM THE SALE OF STOCKS, BONDS, AND OTHER INTANGIBLE PERSONAL PROPERTY ARE DERIVED FROM THE USE OF BUSINESS ACUMEN AND KNOWLEDGE OF INVESTMENTS. TAXATION OF SUCH NET GAINS FROM HUMAN ENDEAVOR IMPOSES NO PERCEPTIBLE BURDEN UPON THE INTANGIBLE PROPERTY SOLD—EVEN THOUGH IT CONSIST OF TAX-EXEMPT BONDS.

The nature of income derived from the sale of property at a profit has been referred to by this court frequently as the gain derived from capital and labor combined.

See, *e.g.*, *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 415;
Doyle v. *Mitchell Bros. Co.*, 247 U.S. 179, 184-185;
Eisner v. *Macomber*, 252 U.S. 189, 207—

where it was said:

> "After examining dictionaries in common use (Bouv. L.D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence* v. *Howbert*, 231 U.S. 399, 415; *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 185)—'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle Case* (pp. 183, 185)."

See also *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U.S. 509, 517-520—

where the use of human ingenuity in obtaining a profit from sales even in isolated transactions was held to produce income.

See *Taft* v. *Bowers*, 278 U.S. 470, 481-482.

That the base of the tax in the case at bar and in cases arising under the Massachusetts Tax Act is the net gain from dealings in intangible personal property can hardly be disputed (see *Merchants Loan & T. Co.* v. *Smietanka*, 255 U.S. 509, 519-520; *Doyle* v. *Mitchell Bros. Co.*, *supra*, at p. 185; see *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531). What is subjected to tax is the gross amount of profits derived from all the transactions of the taxpayer during the taxable year in intangible property, less all the gross losses suffered by the taxpayer in such dealings during the same period. The base of the tax represents the net product of the ingenuity of the taxpayer in employing his capital in realizing gains from dealings in particular commodities. The commodities themselves

are not by the statute subjected to tax. The distinction between *a tax on intangible property or upon the interest or dividends derived from such property* and *a tax on gains from dealings in such property* was expressed clearly by *Rugg*, C.J., in *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531:

> "The tax upon interest and dividends is levied upon a return which comes to the owner of the principal security without further effort on his part. The tax upon excess of gains over losses in the purchases and sales of intangible personal property is levied, not upon income derived from a specific property but from the net result of the combination of several factors, including the capital investment and the exercise of good judgment and some measure of business sagacity in making purchases and sales. Gain derived in this way, to express it in 'summary and comprehensive form,' 'is the creation of capital, industry, and skill.' *Wilcox* v. *County Commissioners*, 103 Mass. 544. It is not the production of capital alone and does not arise solely from a simple investment."

It is submitted that to subject to a non-discriminatory tax on income the product of human effort realized in the form of gains upon the sale of so-called "tax exempt" obligations is to impose no substantial or unconstitutional burden upon the obligations themselves, provided no tax is laid upon the principal amount of the obligations or upon the interest paid by the government issuing the obligations.

II.

THE IMPLIED PROHIBITIONS OF THE CONSTITUTION OF THE UNITED STATES PROTECT THE OBLIGATIONS OF ONE MEMBER OF OUR SYSTEM OF DUAL SOVEREIGN GOVERNMENTS ONLY FROM TAXATION BY THE OTHER GOVERNMENT WHICH BURDENS DIRECTLY AND SUBSTANTIALLY THE OBLIGATIONS THEMSELVES OR THE INTEREST UPON THEM.

The freedom of state bonds and the interest upon them from property taxation by the Federal Government and the similar immunity from state taxation enjoyed by Federal bonds and the interest upon them are well settled. Historically, the exemption has been construed by this court principally in cases where the obligations themselves, or the interest payable by the terms of the obligations, were directly submitted to a property tax—

See, *e.g.*, *Miller* v. *Milwaukee*, 272 U.S. 713;
National Life Insurance Co. v. *United States*,
277 U.S. 508, 520—

or to what was construed by this court as having the effect of a direct property tax upon the bonds themselves or the interest upon them.

See, *e.g. Macallen Co.* v. *Massachusetts*, 279 U.S. 620.
Cf. Flint v. *Stone Tracy Co.*, 220 U.S. 107, 162-165.

The bonds of a State or of the Federal Government are not, by reason of their tax-exempt feature, removed

from the possibility of being used as the subject of commercial transactions and of market speculation—in which individuals take advantage of their judgment of economic conditions to obtain a profit by purchasing at a low price and selling at a high (see the ingenious argument 43 *Harvard Law Review*, 280, 284, December, 1929). The fruits of human ingenuity, even when employed in intimate relationship with a state government, are not always exempt from taxation by the Federal Government.

> *Metcalf & Eddy* v. *Mitchell*, 269 U.S. 514.
> *Lucas* v. *Howard*, Supreme Court of the United States, Oct. Term, 1929, No. 52, decided December 9, 1929.

The taxation of gains derived from the sale of exempt bonds—as the product of the joint employment of business judgment and capital—bears, we submit, far less directly upon the principal amount of the bonds than the legacy taxes sustained in *Plummer* v. *Coler*, 178 U.S. 115, and in *Blodgett* v. *Silberman*, 277 U.S. 1, 12, and the estate tax held valid in *Greiner* v. *Lewellyn*, 258 U.S. 384. Excise taxes upon corporations owning exempt bonds are sustained when the burden upon the bonds is incidental and casual—though the bonds add to the value of the privilege taxed.

> *Provident Institution* v. *Massachusetts*, 6 Wall. 611.
> *Hamilton Co.* v. *Massachusetts*, 6 Wall. 632.
> *Society for Savings* v. *Coite*, 6 Wall. 594.
> *Home Insurance Co.* v. *New York*, 134 U.S. 594.
> *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 162-165.
> *Cf. Macallen Co.* v. *Massachusetts*, 279 U.S. 620, 628.

The tax in the case at bar touches no portion of the taxpayer's investment. It touches no increment of wealth upon that investment to which he became entitled by the terms of the contract contained in the bond he bought. It touches only a profit arising from changed external business circumstances, which the taxpayer has foreseen and of which the taxpayer has taken advantage.

Doubtless there are exemptions and immunities from Federal action which could be added to municipal bonds making those bonds more marketable. However, the necessity that two governments operate within the same geographical area makes it necessary that the exemption granted to the obligations and instrumentalities of one of these governments from taxation by the other be given a practical construction.

> See Mr. Justice *Stone*, speaking for the Court in *Metcalf & Eddy* v. *Mitchell*, 269 U.S. 514, 522-524.

The indefinite and shadowy nature of the casual and indirect burden of the tax involved in the case at bar upon the ability of the subdivisions of States to borrow money should, we submit, lead this court to decide that the tax imposed is not prohibited by any express or implied provision of the Constitution of the United States.

Respectfully submitted,

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